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IN THE

Supreme Court of the United States

OCTOBER TERM, 1942.

No. 66

EMIL H. STRASSBURGER, *Petitioner,*

v.

GUY T. HELVERING, *Commissioner of Internal Revenue*

BRIEF AMICUS CURIAE.

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ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT.

MOTION FOR LEAVE TO FILE BRIEF AMICUS CURIAE.

Comes now the undersigned and moves for leave to file instanter the annexed brief amicus curiae. Counsel for both parties have consented to the filing of this brief.

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BRIEF AMICUS CURIAE.

May It Please the Court:

The points made in this brief are (1) that Congress did not intend to tax a dividend of common stock on identical common stock by section 115 (f) (1) of the Revenue Act. (2) That Congress, by the reorganization provisions of the Act postponed the tax on such a stock dividend until it was sold. This court will avoid a constitutional doubt by construction if possible. See cases collected in opinion of Justice Holmes in *Blodgett* v. *Holden*, 275 U. S. at page 148.

If either of the above points is well taken it is unnecessary to consider whether the *Macomber* case was rightly decided. (3) However it is argued herein that it was rightly decided.

The Legislative History of 115 (f) (1) of the Internal Revenue Code Enacted in 1936 Was Not Intended to Tax Stock Dividends Which Were Held Not to Be Income by Eisner v. Macomber, 252 U. S. 189.

Before the enactment of Section 115 (f) (1) of the Revenue Act of 1936, Congress had, since 1921, expressly exempted all stock dividends from tax. *Helvering* v. *Gowran*, 302 U. S. 238.

In *Koshland* v. *Helvering*, decided May 18, 1936, 298 U. S. 441, this court, at pages 445 and 446, restated our constitutional law to be as follows:

"Under our decisions the payment of a dividend of new common shares, conferring no different rights or interests than did the old,—the new certificates, plus the old, representing the same proportionate interest in the net assets of the corporation as did the old,—does not constitute the receipt of income by the stockholder. On the other hand, where a stock dividend gives the stockholder an interest different from that which his former stock holdings represented he receives income. The latter type of dividend is taxable as income under the Sixteenth Amendment."

This decision was inserted in the Congressional Record while Congress was considering the Revenue Act of 1936 (see speech of Senator Black, 80 Cong. Rec. 8811). This speech also recognizes dividends of common on common stock were not taxable.

When Section 115 (f) of the Revenue Act of 1936 was being considered by the House, Representative Vinson, majority member of the Ways & Means Committee which reported the 1936 act, and the member in charge of the bill, was questioned by Mr. Treadway, ranking minority member of the Ways & Means Committee, concerning its purpose and he plainly stated it was not intended by it to tax stock dividends which were held not to be income by *Eisner* v. *Macomber*. This discussion is set forth in 80 Cong. Rec. 6309 and is as follows:

"Mr. Treadway: May I ask the gentleman one question?

"I think he has covered subdivision (j) very thoroughly. Now, referring to section (f), taxable stock dividends, which is, of course, entirely new, that is, the principle is entirely new in that there is a set-up there under which stock dividends can be taxed, which has not been in the previous law. I am correct in that?

"Mr. Vinson of Kentucky. If the gentleman from Massachusetts will permit, under the 1934 act there was a provision that said no stock dividend should be taxed. In a very celebrated case, Eisner against Macomber, the Supreme Court held that the tax dividend involved in that case was not taxable. Out of that case grew up the idea that no stock dividend was taxable. I think it was because of that notion that the language to which I have referred, as appears in the 1934 bill, found its way there; that is, that no stock dividend should be taxed.

"**The proposed plan does not change the law and does not in the slightest degree strike at the decision of the Supreme Court in the case of Eisner and Macomber in respect of a stock dividend where there is no change in the proportion of ownership by the shareholder.**"

Again at page 6214 Congressman Vinson said:

"Existing law provides no stock dividend shall be taxed. We strike them from this bill. There are innumerable types of stock dividends that are taxable under the Constitution and under the celebrated case of *Eisner* v. *Macomber*."

The government's brief in this court in the *Gowron* case (signed by Justice Reed and case argued by Justice Jackson) makes this statement at page 21, after quoting the foregoing:

"The Congressional understanding that the 1936 Act did not change the law is a factor of great weight in construing the prior acts of Congress on the same subject. *Tiger* v. *Western Investment Co.*, 221 U. S. 286, 309. *Cope* v. *Cope*, 137 U. S. 682, 688. *United States* v. *Freeman*, 3 How. 556."

Also, the fact that Section 115 (f) (1), read literally, does not impose any tax but simply declares a super-

fluous rule and thus throws one back for the tax imposing section to the definition of dividend in the Internal Revenue Code brings the case squarely within Justice Holmes' opinion in *Towne* v. *Eisner*, 245 U. S. 418. Note the government's reliance on sec. 22 (Br. p. 10).

As said in *District of Columbia* v. *Murphy*, 314 U. S. 441, 449:

> "To ascertain its meaning we therefore consider the congressional history of the Act, the situation with reference to which it was enacted and the existing judicial precedents, with which Congress may be taken to have been familiar in at least a general way."

Again at page 454 the court said:

> "A contrary decision would disregard the statements made on the floor of Congress as to the meaning of the statute, fail to give proper weight to the trend of judicial decisions, with which Congress should be taken to have been cognizant. * * *"

Note 8 on page 13 of the government brief is not applicable because the statements there were not of a member in charge of the bill.

Also, regard should be had to the contemporaneous administrative construction of the law. The Treasury Department, in its regulation, published immediately after the enactment of section 115 (f), gave an example which states that a dividend of common on common stock was not subject to tax (this example is in the regulation at p. 52, (government brief). This continued unchanged until 1940 and meanwhile, although enacting revenue acts, Congress did not change the law. It is presumed to have known this regulation and if it intended to tax a dividend of common on identical common stock would have changed

the law. Also, it is to be borne in mind that between the date of the original enactment of this provision of the Revenue Act the Board of Tax Appeals and the courts repeatedly recognized and applied *Eisner* v. *Macomber* (for such recognition see *Foster* v. *United States*, 303 U. S. 118, 121, 122, note 9) but Congress, although enacting revenue laws, never declared a dividend of common on identical common stock should be taxable.

Had Congress intended to tax a dividend of common stock on identical common stock it would have amended section 112 (b) (2) and 112 (b) (3) of the Internal Revenue Code. It is contended in this brief that these sections sustain the decision in the *Sprouse* case and compel the reversal of the decision in the case at bar.

Section 112 (b) (2) and Section 112 (b) (3) of the Internal Revenue Code Postpone Taxes on Stock Dividends Until the Same Are Sold.

The decisions of this court in the *Phellis*, 257 U. S. 156; *Rockefeller*, 257 U. S. 176, and *Marr*, 268 U. S. 536 cases resulted in the enactment by Congress of the first non-recognition of gain provisions covering reorganizations, in the Revenue Act of 1924. Congress did so in order that taxes might be postponed where there was no real change in the interest of the shareholder but merely a change in the form of that interest. Under those provisions none of the transactions in those cases, cited at page 32 of the government brief, would have been taxable and such transactions are not taxable now. Note reference in committee report (C. B. 193—part 2, page 189) to "technical constructions which are economically unsound." In Studies in Federal Taxation, Second Series, page 4, note 4, Mr. Paul shows how this court's decision in the *Marr* case resulted in the reorganization provisions being enacted.

A decision below must be affirmed even if the ground upon which it was put below be wrong, if it may be sustained by any facts appearing of record. *Bondholders Committee* v. *Commissioner*, 315 U. S. 189, 192; *Le Tulle* v. *Scofield*, 308 U. S. 415, 421; *Helvering* v. *Gowran*, 302 U. S. 238, 245.

Section 112 (b) (2) of the Internal Revenue Code reads as follows (It is claimed to be applicable in the *Sprouse* case):

> "**Stock for Stock of Same Corporation.**—No gain or loss shall be recognized if common stock in a corporation is exchanged solely for common stock in the same corporation, or if preferred stock in a corporation is exchanged for preferred stock in the same corporation."

In *Marr* v. *United States*, 268 U. S. 536, this court said of *Eisner* v. *Macomber*:

> "It was as if the par value of the stock had been reduced and three (3) shares of reduced par value stock had been issued in place of their two (2) shares, that is, there was an exchange of certificates but not of interest."

With reference to the case at bar, section 112 (b) (3) of the Internal Revenue Code reads as follows:

> "**Stock for Stock on Reorganization.**—No gain or loss shall be recognized if stock or securities in a corporation a party to a reorganization are, in pursuance of the plan of reorganization, exchanged solely for stock or securities in such corporation or in another corporation a party to the reorganization."

Section 112 (g) of the Internal Revenue Code reads:

> "The term reorganization means * * * (E) a recapitalization."

The facts stated on page two of the government's brief show that the corporation's articles of incorporation were amended on December 11, 1936 to provide that it might issue five hundred (500) shares of One Hundred ($100.00) Dollar par value seven percent cumulative non-voting preferred stock and that ten days later the resolution was passed to distribute this stock to the shareholder. There was, unquestionably, a recapitalization of the corporation (defined by the statute to be a reorganization) and the shares were distributed in pursuance of the plan to the corporate shareholder and under the foregoing quotation from the *Marr* case there was an exchange of the rights represented by the certificates. *Cf. Bass* v. *Commissioner*, 129 F. (2d) 300.

Not only that but the reason and policy of these statutory enactments certainly applies here and the result should not turn on a quibble about the meaning of "exchange." To do so would be to subvert substance to form. As said by the court, through Mr. Justice Black, in *Helvering* v. *Lazarus & Co.*, 308 U. S. at page 255: "In the field of taxation administrators of the laws and the courts are concerned with substance and realities." So is Congress.

Eisner v. Macomber Was Rightly Decided.

At the top of page 5 of its brief the government states the only question (in view of the decision in the *Macomber* case) "is whether the tax is direct and therefore subject to the apportionment requirement." What is a direct tax is not only stated in *Bromley* v. *McCaughn*, 280 U. S. 124, but the briefs in the *Pollock* case exhaust the learning on the subject.

In the *Macomber* case it was decided the tax was "direct" being on the stock itself. The court is not only referred to that decision but to the able brief filed in that case by a former Chief Justice of this court on that question and inasmuch as if and when the court reaches this point we assume it will very carefully read and study that brief, its cogent and convincing arguments are not repeated here.

However, the above quoted argument of the government shows the utter irrelevancy of the statement at the bottom of page 23 and the top of page 24 of the government brief that the courts of Massachusetts and Wisconsin have adhered to their decisions taxing stock dividends after the *Macomber* decision because, although such a tax is a direct tax, the states, unlike the federal government, have authority to levy it without apportionment. *Cf. Pasados* v. *Warner Co.*, 279 U. S. 340, 346. Besides stock dividends were only taxed in Massachusetts for a few years after the *Macomber* case, as pointed out in *Commissioner* v. *Morgan*, 306 Mass. 305. Not only did the legislature repeal the tax but also the Wisconsin court proceeded to limit its decision by holding a stock dividend out of appreciation of assets not taxable. *State ex rel Hanson* v. *Cary*, 191 Wis. 153. Also, the Sixteenth Amendment certainly was not intended to do away with apportionment except as to what was in fact income. Hence, if a stock dividend is not income the quotation on page 25 of the government brief is irrelevant unless it be contended the amendment was intended to authorize a tax on real estate and all direct taxes without apportionment. (The discussion of direct taxes at pages 17 and 18 of the government brief is found in *Bromley* v. *McCaughn*, 280 U. S. 124.)

The Basis of the Macomber Decision Is That One Who Exchanges a Ten Dollar Bill for Ten One Dollar Bills Thereby Receives No Income.

If the above proposition is right then the tax cannot be on income for there is no income. If not on income then, as pointed out in the *Macomber* case brief and held in that case, it is a direct tax on the stock itself which the Constitution requires to be apportioned. In the taxpayer's brief in *Eisner* v. *Macomber*, the former Chief Justice of this court stated the pith of the case as follows:

> *"The dividend takes nothing from the corporation and gives nothing to the stockholder. The corporation is no poorer after it has been paid. THE STOCKHOLDER IS NO RICHER THAN BEFORE AND SO RECEIVES NO INCOME."*

In *Edwards* v. *Chile Copper Co.*, 270 U. S. 452, Justice Holmes said, at page 455:

> "We canot let the fagot be destroyed by taking up each item of conduct separately and breaking the stick. The activities and situation must be judged as a whole."

The government's argument against the *Macomber* case disregards this injunction and separates the decision into parts and tries to break each part separately whereas the decision was made on the situation as a whole.

The doctrine that a stock dividend is not income has been adopted throughout the English speaking world. See the following decisions of the House of Lords: *Commissioners* v. *Blott*, 2 A. C. 171, 195, 202; *Inland Revenue Commissioners* v. *Fisher* (1926), A. C. 395, and by the privy council in an appeal from India: *Commissioners* v. *Mercantile Bank* (1936) A. C. 478. In Australia the high court

overruled its prior contrary decision and followed the *Macomber* case and the courts of Canada have followed it.

Arguing for the taxpayer in the *Blott* case, Sir John Simon said (p. 175):

> "The point is that the stockholder has now got capital asset and that the same thing cannot be at the same time capital in the hands of the company and income in the hands of the shareholder."

Discussing the *Macomber* decision in 37 Harvard Law Review 1, at page 8, Professor Beale says the stockholder has received nothing and unless he sells his stock may never receive anything because the corporation may lose the money the stock represents.

At pages 8 and 40 the government argues a taxpayer is no wealthier immediately before he sells a capital asset than thereafter. If this were so there would be no stores open in Washington or elsewhere. Also there would be no damages for breach of a sale contract because a near vendor would suffer no damage if a buyer backed out of a sale at the last moment. According to the government he would be as well off.

On page 37 the government says *Helvering* v. *Brunn*, 309 U. S. 461, (which was set aside by section 115 of the Revenue Act of 1942) is contrary to the *Macomber* case. That case dealt with an entirely different state of facts. It is possible to sever money from a corporation by a dividend but not buildings (except castles in the air) from land and have them worth anything except to the buyer of old materials. Besides the owner of the land was richer after than before the building was forfeited to him. In the *Brunn* case this court distinguished the situation at pages 468, 469.

The *Kirby* case, cited on page 36 of the government brief was set aside by section 114 of the Revenue Act of 1942 and the Court of Appeals' decisions collected in note 23 on page 37 were decided before a contrary view was announced in *Palmer* v. *Commissioner*, 302 U. S. 63, 69. An increase in the value of property does not result in taxable income. *Bingham* v. *Long*, 249 Mass. 79.

No example can be given to show where the *Macomber* case has restricted Congress. It does not prevent taxing the annual income of a corporation to its stockholders because stock dividends generally are issued against accumulations over a period of years and also the stockholder receiving them may not have owned his stock during the years the corporation earned the profits.

At page 43 it is said the decision impelled Congress to abandon taxing corporate profits accumulated to avoid surtax, to stockholders. If so, this has worked to the benefit of the revenue. For example, in the case of the *Chicago Stock Yards Company*, No. 488 herein, the taxes and penalties due to the method Congress adopted exceeded four million whereas had the profits been taxed to the stockholders instead, the taxes would have only been approximately $1,300,000. (See 41 B. T. A. 611, finding 37.)

The Overruling of Eisner v. Macomber Will Harm the Revenue.

Should the *Macomber* case be overruled taxes will be collected from the people who received stock dividends in reliance on it only for the three years not barred by Statute if the Commissioner, in a sense of justice, does not

declare its overruling not retroactive by virtue of the power granted him under section 3791 (b) of the I. R. C. or if Congress does not do so. After *Helvering* v. *Hallock*, 309 U. S. 106, had overruled the *St. Louis Trust Co.* case the Commissioner, in T. D. 5008 C. B. 1940-2, page 286, declared the decision not retroactive as to trusts created between the date of the *Hallock* and *St. Louis Union Trust Co.* decisions.

Also, if the *Macomber* case is overruled the flood of stock dividends declared from 1920 to 1938 will all take a basis of market value at date of receipt for computing profit upon sale by their owners. (For converse situation see *Bigelow* v. *Bowers*, 68 F. (2d) 839, cer. den. 392 U. S. 656.) The revenue will lose millions unless Congress intervenes. (See testimony of this amicus curiae in 1942 Senate Finance Committee Hearings, page 1021.)

As to the future, the following observation in the 1942 Senate Report, No. 1631, on the capital asset sections, at page 49, is pertinent:

> "The realization of capital gain is entirely a matter within the discretion of the taxpayer. If the rates are too high the government will lose not only income taxes but also stamp taxes upon the transfer of property."

If stock dividends are taxable none will be declared and the market sales which take place when many shares are outstanding will not take place unless the same thing be accomplished through a tax free reorganization in which the corporation recapitalizes and changes the par value of its shares and the stockholders exchange one old share

for a number of new ones. (See argument, *supra*, that this case is substantially the same and should be so treated.)*

CONCLUSION.

At page 45 of its brief the government states the decision below is correct under *Koshland* v. *Helvering*, 298 U. S. 441, because the stock dividend (in this and in the *Sprouse* case) did not represent rights identical to those represented by the stock on which it was declared. See also its response to the petition for certiorari.

If so, it is submitted the court should not go out of its way to reconsider a great constitutional decision which a glance at the citator will show has been cited and followed innumerable times. Since Chief Justice Taney went out of his way in the *Dred Scott* case this court has refrained from doing so.

All of which is respectfully submitted.

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*At no time in the history of this court have so many of its decisions been set aside by Congress as its tax decisions made in the last few years. The following decisions were set aside by the Revenue Act of 1942: **Crane-Johnson Co., v. Helvering**, 311 U. S. 54 and **Northwest Steel Rolling Mills**, 311 U. S. 46, by section 501. **Helvering v. Enright**, 312 U. S. 636, by section 134. **Higgins v. Commissioner**, 312 U. S. 212, by section 121. **Helvering v. Brann**, 309 U. S. 461, by section 115. **United States v. Nummally Investment Co.**, 313 U. S. 584, by section 503. As noted by the court in the **Southwest Consolidated** case, its decision in the **Hendler** case was set aside by the prior revenue act.